Supreme Court, U. S.
FILED
SEP 22 1978
JR., CLERK

SUPREME COURT OF THE UNITED STATES

October Term, 1978

No. 78-293

AVERY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al. - - - - - **Appellants**

versus

WILLIAM D. MEYERS, et al., Commissioners of the Sinking Fund of the City of Louisville - - - - - - - - - **Appellees**

On Appeal From the Court of Appeals of Kentucky

APPELLANTS' BRIEF OPPOSING MOTION TO DISMISS APPEAL

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TABLE OF CONTENTS

	PAGE
Appellants' Brief Opposing Motion to Dismiss Appeal	1– 6
Conclusion	6– 7
Appendix J	9–12
Appendix K	13–14
Appendix L	15–16

TABLE OF AUTHORITIES CITED

Cases: PAGE

Educational Films Corp. v. *Ward*, 282 U. S. 379 (1931) 2, 6

Flint v. *Stone Tracy Co.*, 220 U. S. 107 (1911) 2–3, 4

Home Insurance Co. v. *New York*, 134 U. S. 594 (1890) 2

Pacific Co. v. *Johnson*, 285 U. S. 480 (1932) 2

Provident Institution v. *Massachusetts*, 6 Wall. (73 U. S.) 611 (1868) 2, 3

Reuben L. Anderson-Cherne, Inc. v. *Comm'r of Taxation*, 303 Minn. 124, 226 N. W. 2d 611, app. dism'd 423 U. S. 886 (1975) 2

Society for Savings v. *Coite*, 6 Wall. (73 U. S.) 594 (1868) 2, 3

Tradesmens Bank v. *Tax Comm'n.*, 309 U. S. 560 (1940) 2

Werner Co. v. *Director of Taxation*, 350 U. S. 492 (1956) 2, 3

Constitutional Provisions, Statutes and Ordinances:

31 U.S.C. §742 (R.S. §3701) 1, 5, 6

Kentucky Revised Statutes:

§136.070 ..... 3, 4

§136.290 4

§136.300 4

General Ordinances of the City of Louisville:

§727.02 4

§727.05 6

§727.06 6

Miscellaneous:

Legislative History of 31 U.S.C. §742 ..... 5, 6

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The vices of the Sinking Fund's "Counterstatement of Question Presented" are that it tracks the language of 31 U.S.C. §742 (R.S. §3701) and asks an abstract question. It avoids the relevant, concrete question which is, Is the tax in issue the kind of tax contemplated by the words "nondiscriminatory franchise . . . taxes . . . imposed on corporations"? The answer to this concrete question is "no" for the following reasons.

Before the 1959 amendment to 31 U.S.C. §742, many of this Court's decisions, some of which the Sinking Fund cites, approved taxes where federal, state or local

obligations were part of the measure of the tax. Cases cited by the Sinking Fund involved four categories of franchise taxes imposed upon corporations:

(a) by states and measured by net assets or net worth, *Society for Savings, Provident Institution* and *Werner Machine Co.;*

(b) by states and measured by net income, *Tradesmens, Educational Films, Pacific Co.,* and *Reuben L. Anderson;*

(c) by a state and measured by dividends paid or value of capital stock, *Home Insurance;* and

(d) by the federal government and measured by net income, *Stone Tracy.*

The common elements of all of the taxes approved in the foregoing decisions are that (1) the levies were exclusively upon corporations, (2) they were nondiscriminatory as to federal, state or local obligations in that such obligations were treated the same as any other assets or income of the corporation, and (3) the thing taxed was the privilege of doing business in corporate form.

Mr. Justice Day, speaking for the Court in *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 161-2 (1911), explained the true incidence of the corporate excise tax approved there and in the other foregoing cases:

> "In the case at bar we have already discussed the limitations which the Constitution imposes upon the right to levy excise taxes, and it could not be said, even if the principles of the Fourteenth Amendment were applicable to the present case, that there is no substantial difference between the carrying on of business by the corporations taxed, and the same business when conducted by a private firm or individual. The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conducting business with the advantages which inhere in the corporate capacity of those taxed, and which are not enjoyed by private firms or individuals. These advantages are obvious, and have led to the formation of such companies in nearly all branches of trade. The continuity of the business, without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock, the advantages of business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted, which do not exist when the same business is conducted by private individuals or partnerships. It is this distinctive privilege which is the subject of taxation, not the mere buying or selling or handling of goods which may be the same, whether done by corporations or individuals."

The Commonwealth of Kentucky itself, as distinguished from Louisville and Jefferson County, has corporate taxes similar to those approved in *Society for Savings, Provident Institution,* and *Werner Machine Co.* The Kentucky corporation license tax of general application is found in Kentucky Revised Statutes (KRS) §136.070, printed in Appendix J. That statute imposes upon foreign and domestic corporations "an annual license tax of seventy cents (70¢) on each one thousand dollars ($1,000) of the capital em-

ployed in the business." Subsection (5) provides: "No corporation required to pay an annual license tax under this section shall pay less than ten dollars." Savings and loan associations are exempt from paying the foregoing tax but are subject to a similar tax imposed by KRS §§136.290 and 136.300, printed in Appendix K. As provided in these last sections, savings and loan associations pay a tax of $1 for each $1,000 on their capital stock.

In contrast to the Kentucky, state and federal corporate taxes discussed above, the tax which the Sinking Fund administers is characterized by the Sinking Fund itself as "a general occupational license tax" (Motion, pages 2, 3, and 4). The word "general" is indeed correct. Far from being a tax upon corporate franchises, this is a tax levied upon "every person, association, corporation or other entity engaged in any occupation, business, trade, profession or other activity in the City . . . for the privilege of engaging in said activities" (§727.02(a)) (Jurisdictional Statement, Appendix B). For all save employed, natural persons, the tax is upon net profits. Unlike the tax imposed by KRS 136.070 (5), there is no minimum tax of $10 or any other sum.

The words of Mr. Justice Day in *Stone Tracy* quoted above are particularly apt in that the city tax is imposed upon business activities "in which the actual transactions may be the same, whether conducted by individuals or corporations." The thing taxed is not the privilege of doing business in corporate form.

The Commonwealth has granted domestic corporations their franchises and, as seen above, has enacted

corporation license taxes. The Sinking Fund, on its own, has attempted to make a corporate franchise tax out of the Louisville tax by singling out the corporate taxpayers, ignoring the fact that the tax falls alike upon "every person, association, corporation or other entity," and declaring, without benefit of any statute or ordinance, that as to corporations, the "tax is imposed for . . . the exercising of their corporate franchises in Louisville" (Motion, page 4). The Sinking Fund says "this appeal relates exclusively" to corporate taxpayers (*Ibid.*), but the tax itself is not imposed exclusively upon corporate taxpayers.

The associations quoted the legislative history of the 1959 amendment to 31 U.S.C. §742 (Jurisdictional Statement, page 10). The Sinking Fund agrees that one purpose of the amendment was to codify past decisions of this Court creating exceptions to the general prohibition against any kind of state taxation on federal obligations (Motion, page 6). The Sinking Fund, however, ignores another important purpose, which, the history states, was to "prohibit a State from including interest on Federal obligations in computing 'gross income' upon which taxable net income is determined." In short, that aim was to prevent state and local governments from subjecting federal obligations to income taxation.

The associations have already demonstrated that the tax is an income tax by the way it operates (Jurisdictional Statement, pages 11-16). The Sinking Fund failed to challenge the demonstration and says that the associations rely only upon the "simplistic proposi-

tion" that the tax is an income tax only because it is "measured by income" (Motion, page 6). The Sinking Fund likens this tax to the one approved in *Educational Films,* saying, "when business ceases, so does liability for the tax" (Motion, page 8). In *Educational Films,* the past year's profits measured the tax to be paid in advance for doing business in the corporate form during the coming year. Not so with the Louisville tax. No tax is paid in advance but only after the year's end and, not then, unless there are net profits. (General Ordinances of the City of Louisville, §§727.05 and 727.06, printed in Appendix L.) The associations invite the Court's careful study of the analysis of the tax made at the cited pages of the Jurisdictional Statement to understand the tax as an income tax. "[T]he nature of a tax must be determined by its operation rather than by particular descriptive language which may have been applied to it." *Educational Films Corp.* v. *Ward,* 282 U. S. 379, 387 (1931). As an income tax, the Louisville tax is not within any exception to 31 U.S.C. §742.

CONCLUSION

This Court has never allowed a tax such as this one. This Court has never permitted states or localities to include interest on federal obligations in the measure of an income tax or of any franchise tax other than one on the privilege of existing as a corporation.

The 1959 amendment to 31 U.S.C. §742 prohibits this tax as an income tax on interest on Government

obligations and it forbids its imposition under the guise of a franchise tax upon corporations, since it is not such a tax.

The Court should therefore overrule the motion to dismiss the appeal.

Respectfully submitted,

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September 25, 1978.

APPENDIX

APPENDIX J

KENTUCKY REVISED STATUTES

136.070 Corporation license tax; exemptions; apportionment

(1) Every corporation organized under the laws of this state, every corporation having its commercial domicile in this state, and every foreign corporation owning or leasing property located in this state or having one or more individuals receiving compensation in this state, except state and national banks and trust companies, savings and loan associations organized under the laws of this state and under the laws of the United States and making loans to members only, production credit associations, insurance companies, including farmers' or other mutual hail, cyclone, windstorm or fire insurance companies, insurers and reciprocal underwriters, public service companies subject to taxation under KRS 136.120, those corporations exempted by section 501 of the Internal Revenue Code, and any other religious, educational, charitable or like corporations not organized or conducted for pecuniary profit, shall pay to the state an annual license tax of seventy cents (70¢) on each one thousand dollars ($1,000) of the capital employed in the business as computed under the provisions of subsections (2) and (3) of this section.

(2)(a) The term "capital" as used in this section means capital stock, surplus, advances by affiliated companies, intercompany accounts, borrowed monies or any other accounts representing additional capital used and employed in the business. Accounts properly defined as "capital" in this section shall be reported at the value reflected on financial statements prepared for book purposes as of the last day of the calendar or fiscal year.

(b) "Capital employed," in the case of corporations having property or payroll only in this state, means "capital" as defined above.

(c) "Capital employed," in the case of corporations having property or payroll both within and without this state means "capital" as defined above and as apportioned under subsection (3) of this section.

(d) Property means either real property or tangible personal property which is either owned or leased. Payroll means compensation, paid to one or more individuals, as described in subsection (3) of this section. Property and payroll are deemed to be entirely within this state if all other states are prohibited by Public Law 86-272, as it existed on December 31, 1975, from enforcing income tax jurisdiction.

(3) The total capital, as determined under subsection (2) of this section, shall be apportioned as follows:

(a) The total capital shall be multiplied by a fraction, the numerator of which is the property factor plus the payroll factor, plus the sales factor, and the denominator of which is three (3).

(b) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period; provided, however, that property which has been certified as a pollution control facility as defined in KRS 224.850 shall be excluded from the property factor.

1. Property owned by the taxpayer is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero such property shall be valued by the department under regulations promulgated by the department. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net

annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals, provided that such rental and such subrentals are reasonable. If the department determines that the annual rental or subrental rate is unreasonable, or if nominal or zero rate is charged, the department may determine and apply such rental rate as will reasonably reflect the value of the property rented by the taxpayer.

2. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(c) The payroll factor is a fraction, the numerator of which is the total amount paid or payable in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid or payable everywhere during the tax period. Compensation is paid or payable in this state if:

1. The individual's service is performed entirely within the state; or

2. The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

3. Some of the service is performed in the state and the base of operation or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(d) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total

sales of the taxpayer everywhere during the tax period. Sales of tangible personal property are in this state if:

1. The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within this state regardless of the f.o.b. point or other conditions of the sale; or

2. The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the purchaser is the United States government.

3. Sales, other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

(4) If the apportionment provisions of this section do not fairly measure the taxpayer's capital in this state, the taxpayer may petition for or the department may require:

(a) The exclusion of any one or more of the factors;

(b) The inclusion of one or more additional factors which will fairly measure the taxpayer's capital in this state; or

(c) The employment of any other method to produce an equitable apportionment of the taxpayer's capital.

(5) No corporation required to pay an annual license tax under this section shall pay less than ten dollars.

HISTORY: 1976 H 549, § 5, eff. 6-19-76

1974 S 179, § 3, H 490, § 1; 1972 H 394, Pt II, § 1; 1970 H 22, § 4; 1966 c 187, Pt II, § 1, c 255, § 129; 1962 c 94, § 1; KS 4189-1, 4189-2, 4189-8

APPENDIX K

KENTUCKY REVISED STATUTES

136.290 Report of savings and loan, bank for cooperatives, and production credit associations; value determination; notice

(1) Every domestic savings and loan association, bank for cooperatives, and every production credit association making loans to members only shall, during January of each year, file with the department of revenue a report containing such information and in such form as the department may require.

(2) The department shall fix the total value, as of January 1 of each year, of the capital stock composed of shares of each savings and loan association and production credit association, excepting the share of borrowing members where the amount borrowed equals or exceeds the amount paid in by those members. The department shall immediately notify each association of the value so fixed.

HISTORY: 1972 H 390, § 2, eff. 6-16-72

1970 H 22, § 2; 1966 c 255, § 130; 1960 c 186, Art I, § 36; 1949 ex s, c 4, § 19; KS 4019a-6

136.300 Rate and payment of tax; exemption from other taxes; charging against dividends

(1) By July 1 succeeding the filing of the report provided for in KRS 136.290, each domestic savings and loan association, bank for cooperatives, and each production credit association shall pay directly into the state treasury a tax of one dollar for each one thousand dollars paid in on its capital stock as fixed in KRS 136.290. The individual shareholders shall not be required to list their shares for taxation for any purpose. The association or bank for cooperatives shall not be required to pay local taxes upon

its capital stock, surplus, undivided profits, notes, mortgages, or other credits, and the tax provided by this section shall be in lieu of all taxes for state purposes on property of the association or bank for cooperatives. Failure to make reports and pay taxes as provided in this section and in KRS 136.290 shall subject the association or bank for cooperatives to the same penalties imposed for such failure on the part of the other corporations.

(2) If a domestic savings and loan association, bank for cooperatives, or production credit association so elects, it may deduct taxes imposed in subsection (1) of this section from the dividends paid or credited to a nonborrowing shareholder.

HISTORY: 1972 H 390, § 3, eff. 6-16-72

1970 H 22, § 3; 1966 c 255, § 131; KS 4019a-7, 4019a-8

APPENDIX L

GENERAL ORDINANCES OF
THE CITY OF LOUISVILLE

727.05 Returns.

Each person subject to a license fee imposed by this chapter shall, on or before the fifteenth day of the fourth month following the close of each year, make and file with the Commissioners of the Sinking Fund a return, in duplicate, on a form furnished by or obtainable from the Commissioners of the Sinking Fund, setting forth the aggregate amount of salaries, wages, commissions and other compensation or net profits during the preceding year with such other pertinent information as the Commissioners of the Sinking Fund may require. Provided, however, that where the entire license due under this chapter has been withheld under the provisions hereof, the Commissioners of the Sinking Fund may waive the filing of said return by such licensee. Provided further that where the fiscal year of the business, profession, or other activity differs from the calendar year and licensee files federal income tax return of such other fiscal period the license fee shall be measured by the net profits of the fiscal year and where the return is made for a fiscal year or any other period different from a calendar year, the said return shall be made on or before the fifteenth day of the fourth month following the end of the said fiscal year or other period. Such return shall also show the amount of the license fee imposed by this chapter. (1958 G.O. Sec. 67-6.)

727.06 Payment.

The person making the said return shall, at the time of the filing thereof, pay to the Commissioners of the Sinking

Fund the amount of license fees shown as due thereon; provided, however, that where any portion of the license fee so due shall have been deducted at the source, credit for such amount shall be deducted from the amount shown to be due and only the balance, if any, shall be due and payable at the time of the filing of said return, as hereinabove provided; and

provided further it shall be the duty of each employer who has deducted the license fee from the wages, salaries, commissions, or other compensation referred to in Section 727.04 above, to furnish said employee a statement showing the amount of salary earned and license fee deducted and paid by said employer during the preceding calendar year on or before February 15 of each year. (1958 G.O. Sec. 67-7.)